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UNCLAS SECTION 01 OF 03 SANTO DOMINGO 006609

SIPDIS

SENSITIVE

STATE FOR WHA/CAR, WHA/EPSC, WHA/USOAS, EB/TPP/BTA,
EB/IFD/OMA;NSC FOR SHANNON AND MADISON;LABOR FOR ILAB;
USCINCSO ALSO FOR POLAD; TREASURY FOR OASIA-LCARTER
STATE PASS USTR FOR VARGO, RYCKMAN, MALITO, CRONIN
USDOC FOR 4322/ITA/MAC/WH/CARIBBEAN BASIN DIVISION
USDOC FOR 3134/ITA/USFCS/RD/WH; DHS FOR CIS-CARLOS ITURREGUI

E.O. 12958: N/A
TAGS: PGOV PREL ETRD EFIN DR
SUBJECT: DOMINICAN VOTE TO REPEAL PROTECTIONIST TAX -
PYRRHIC VICTORY?

REF: A. SANTO DOMINGO 6292

¶B. FAX TO STATE/WHA/CAR
¶C. TREASURY/OASIA
¶D. USTR 12/3/04

¶1. (SBU) Summary: The Dominican Senate achieved a breakthrough of sorts on December 7 with a preliminary vote (19 to 1) in favor of repealing a protectionist 25 percent tax on beverages containing imported high fructose corn syrup, which for months has been a barrier to Dominican participation in the Central American Free Trade Agreement (CAFTA). The bill goes to a special Senate committee and must be subject to a final vote scheduled for December 15. It must then be approved by the Chamber of Deputies and the President. The measure includes extensive tax breaks for the sugar industry and other businesses, estimated by the administration at USD 150 million -- which would complicate efforts to reach a new IMF agreement. End summary.

A Vote to Repeal -- and More
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¶2. (SBU) The Dominican Senate on December 7 voted on a first preliminary reading to repeal a protectionist 25 percent tax on beverages containing imported high fructose corn syrup, a measure inserted in late September into an otherwise necessary tax package. (The USG has refrained from recommending to Congress that the Dominican republic be a member of CAFTA as long as the 25 percent tax remains in effect.) The vote took place more than two months after President Leonel Fernandez submitted draft repeal legislation. It was preceded by increasingly tense negotiations among the 29 senators (of 32) who belong to the main opposition PRD. The Senate convened for a protracted afternoon and evening session to consider the repeal.

¶3. (SBU) Before the vote, Senate President Andres Bautista -- a proponent of repeal -- angrily criticized senators for repeatedly blocking the repeal and packing the bill with concessions to special interests. Bautista had favored putting the proposed concessions into a separate bill. "I have convoked four Senate sessions to consider this bill and have been boycotted. Now that it's on today's agenda, a new bill is introduced." The new version included the repeal of the tax, but also significant tax breaks for Dominican business. The ultimate objective of the bill, he asserted, was in fact to prevent the repeal of the 25 percent tax and ultimately to block approval of CAFTA. "We understand some senators took naive positions, some had economic motives and others were pushed by the intervention of sectors outside the Senate." Another senator speculated to us Bautista considered that his personal authority had been challenged and weakened in the weeks-long standoff.

¶4. (SBU) Bautista declared the session to be concluded and left the Senate chamber, followed by about eight other senators "in solidarity" with the president. Senate Vice President Cesar Matias took the chair and the 20 who remained voted to resume the session. They voted 19-1 to pass the bill. The sole senator from Fernandez's Dominican Liberation Party (PLD), Jose Tomas Perez, was absent from the chamber. Bautista told us the next day that he considered his vice president's action to be a violation of Senate procedure, but another key senator said that the proceedings were in accordance with the rules.

Key Provisions

¶5. (U) Article 1 of the bill (Ref B draft text) repeals the specific provisions of the September 28 law creating the 25 percent tax on fructose-sweetened drinks and refreshments. The remaining articles define compensatory measures in the form of changes to Dominican tax laws.

¶6. (U) Agricultural enterprises including the sugar sector

are allowed to offset without limit from their tax liabilities any amount spent on repair, maintenance or improvement of capital goods. The sugar sector is allowed to deduct from tax obligations all amounts paid as VAT to its suppliers, with the notation in the preamble that sales of sugar are not subject to VAT. The measure removes capital goods imports from the scope of the current ten percent tax on imports (disguised as an "exchange charge" and proposed for an increase to thirteen percent). Changes to tax incentives for investments in businesses near the Haitian border (Article 6, Ref B) will do little to offset the revenue losses. A concluding article repeals a series of articles and laws identified by dates and references and not further explained, including one that is applicable to alcoholic beverages.

¶7. (SBU) The approved text varies only minimally from the working draft faxed to Washington (Ref B). Language is added to Article 5 specifically emphasizing favorable treatment for the sugar sector. It now reads, in our informal translation:

"All imports of capital goods in general, and inputs to the sugar industry, including but not limited to machinery, equipment and furniture; as well as replacements and parts (los repuestos, partes y piezas) for machines and equipment for industry, into the Dominican Republic shall be exempt from payment of the foreign currency exchange commission or any other charge of similar nature which has been established, or may be established in the future, by the Monetary Board or any other State institution or agency."

Fiscal Impact

¶8. (U) Internal Revenue Director Juan Hernandez told the press after a meeting with the influential Council of Entrepreneurs (CONEP) that the bill would enact tax cuts amounting to 4.5 billion pesos (approximately USD 150 million), obliging a revision of the 2005 government budget (the passage of which is one of several pre-conditions for approval of the IMF standby arrangement). "Everyone has called the budget optimistic already, since the tax collection authorities will have to make an extra effort to meet the objectives -- and if in addition they enact tax cuts, this will create problems with the agreement we've already struck with the IMF." Hernandez said that the measures would create "chaos" in tax administration.

Next Steps to Repeal

¶9. (SBU) Some of the proponents of the free trade agreement are talking of seeking on December 15 simply to pass instead the repeal bill essentially as proposed by President Fernandez, without the tax concessions. If the committee finishes its work as expeditiously as promised and if the Senate approves the bill on December 15, the measure would then pass to the lower house of Congress, where Finance Committee chairman Marino Collante previously assured us that a solid majority (at least 90 out of 150)favors the repeal. Timing is uncertain, and there is no schedule announced as yet for the holiday recess. Once approved by the House, the measure would go to the President for signature and promulgation -- or veto. Under the Constitution the President may return a entire bill to Congress with his "observations," in which case it dies unless overidden wthin eight days by a two-thirds vote in each houses. The current Congressional session has been extended until January 12; the new session will not begin until February 27.

Comment

¶10. (SBU) Many of the senators feel an obligation to protect the domestic sugar industry, as historically important and a provider of employment -- and because of the wealth and influence of the industry owners, expressed through many years of personal connections, favors and contributions overt and under the table. Sugar and fertilizer interests have run an aggressive and mendacious public campaign since signature of CAFTA on August 5. The press and politicians bristled with indignation and feigned patriotic fervor at the message from the Ambassador, the Embassy and senior USG officials that the Dominican Republic was setting itself up for exclusion from CAFTA. All the legislators are now unhappily aware that the U.S. position is firm. We believe the votes are there for repeal of the tax in both houses of the Dominican Congress. There is no sign that there is sufficient principle or indignation among legislators to constitute majority willing to stiff the sugar sector instead of buying it off. The question is how many concessions the sugar sector and agricultural interests will be able to exact.

¶11. (SBU) One great concern is the potential fiscal impact of compensatory measures - the bill lifts the 10 percent

"exchange charge" on a category of expensive imports, while tilting tax treatment sharply in favor of the sugar industry (the Association of Manufacturers has already clamored for similar, "equitable treatment.") The Fernandez administration government and the Congress must be sure that whatever solution emerges takes into account the country's other interests, especially the pressing need for the agreement with the IMF. By seeking to solve one impasse with concessions to agricultural producers and sugar barons, the Dominican Congress could possibly be setting up another impasse, equally dangerous,with the International Monetary Fund.

KUBISKE